Directorate of
Intelligence

~~Secret~~

25X1

5 art.
32 briefs

file copy - do not remove!

International Economic & Energy Weekly

25X1

2 November 1984

~~Secret~~

DI IEEW 84-044
2 November 1984

Copy 694

Page Denied

Secret
[redacted] 25X1

International Economic & Energy Weekly [redacted] 25X1

2 November 1984

[redacted] 25X1

25X1

Comments and queries regarding this publication are welcome. They may be directed to [redacted] *Directorate of Intelligence,* [redacted] 25X1

25X1

Secret 25X1

International Economic & Energy Weekly 25X1

Synopsis

25X1

35 **Morocco-Libya: Implementation of the Union** 25X1

Libya and Morocco are moving rapidly to implement their union agreement and demonstrate that the accord is providing tangible economic benefits. The union also promotes the interests of the two leaders in broadening their international contacts. The long-term viability of this accord, however, will depend in part on Qadhafi's ability to improve his poor track record on financial commitments. 25X1

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000707260001-0

[redacted] 25X1

International Economic & Energy Weekly [redacted] 25X1

2 November 1984

Perspective

The IMF/IBRD Role in LDC Economic Adjustment [redacted] 25X1

The IMF and IBRD are coming under growing pressure to become more involved in the LDCs' long-term economic stabilization programs. Increasingly those LDCs that have complied with short-term IMF-supported programs and have improved their economic situation are looking for the potential reward of financially attractive multiyear reschedulings. Longer term rescheduling, in which debt falling due over the next several years is rescheduled all at once, provides the debtor with more manageable debt repayments and a concrete planning horizon. Moreover, after one to two years of tough austerity measures leading to encouraging economic performance, debtors feel they deserve a longer leash than an IMF program or a one-year Paris Club rescheduling can provide. [redacted] 25X1

Already this year, Mexico and Venezuela have successfully negotiated multiyear packages with commercial banks. Yugoslavia is currently negotiating with its bank creditors on a multiyear rescheduling and has received support from many Western governments and some of its creditors. On the basis of its compliance with an IMF-supported program, Brazil should merit a multiyear package as well. We expect that Argentina and the Philippines—which have only recently signed letters of intent with the Fund—will ask their creditors to consider multiyear rescheduling, but they are less likely to be successful. [redacted] 25X1

While the Fund has been reluctant to get involved with the long-term economic adjustment process, creditors agreeing to multiyear reschedulings insist that some form of IMF economic monitoring continue in the absence of a conditionality program. In both Mexico and Venezuela, the IMF will monitor economic performance despite the fact that it will be lending no money of its own. This form of enhanced Fund review is acceptable to creditors, and it allows enough flexibility that the debtors do not fear a loss of economic sovereignty. [redacted] 25X1

Some observers, particularly the British, contend that the IMF is not equipped to monitor numerous long-term adjustment programs and believe that the World Bank should play a greater role in influencing long-term economic development. Many World Bank officials hope that Secretary Regan's proposal for a debt conference next spring, which will focus on LDC growth and development in a medium-term context, will be a step toward integrating the Bank's more flexible, growth-oriented approach to economic adjustment with the IMF's sharper line of conditionality. We believe that officials in LDCs will be watching the industrial nations for indications of increased financial

commitments to the IBRD that would enable the World Bank to play a larger role in the adjustment process. In particular, they would like to see an increase in structural adjustment loan (SAL) allocations. [redacted] 25X1

We believe the IMF will gradually increase its role in the LDCs' longer term economic adjustment process. In addition to its monitoring role, the IMF may expand its use of the extended arrangements, but use of these two-to-three-year packages would almost certainly entail strict conditionality. While the IBRD will attempt to expand its own involvement, the Bank's SAL program is limited to 10 percent of total IBRD lending in any one year. Furthermore, the IBRD faces capital constraints, and, since donor nations—in particular the Group of 10—favor the IMF's approach to economic assistance with strict conditions attached, they will hesitate to increase financial commitments to the IBRD for nonproject lending. [redacted] 25X1

[redacted] 25X1

Briefs

Energy

Big Seven Oil Consumption Increases

Big Seven oil consumption rose 6 percent in first half 1984 over the same period last year—the first six-month increase since 1979. This increase reflects continued economic recovery in the United States and Japan, colder-than-normal weather in early 1984, and a continuing UK coal strike. Heavy fuel oil consumption in the United Kingdom soared 51 percent, largely as a result of a 200-percent increase in oil use by the electric power industry. UK heavy fuel oil use contrasts with a 10-percent overall decline recorded by the Big Seven. During the same period, Big Seven gasoline and light fuel oil consumption increased by 2 percent and 9 percent, respectively.

25X1

25X1

Major Developed Countries' Oil Consumption

Percent change over year-earlier levels

	First Half				
	1980	1981	1982	1983	1984
Big Seven	**−7.5**	**−7.6**	**−4.2**	**−4.3**	**5.8**
United States	−8.4	−6.7	−4.1	−4.5	6.8
Japan	−6.1	−9.5	−4.1	−3.0	8.3
Canada	−1.7	−5.4	−9.2	−11.5	1.8
France	−6.8	−13.7	−6.8	−2.5	−2.1
Italy	1.7	8.0	−7.3	−4.2	1.0
West Germany	−8.2	−14.1	−2.6	−1.4	0.1
United Kingdom	−15.1	−12.2	4.2	−5.5	12.1

25X1

25X1

Impact of Mexican Oil Cut Uncertain

The size and duration of Mexico's oil export cutback to help defend OPEC prices remain uncertain, although it was scheduled to take effect this week. To our knowledge, PEMEX has yet to inform any of its customers that it is trimming their November allotment. At most, we expect a 10-percent cutback that will last no more than three months. If fully implemented, such a cutback would cost $375 million. Mexico could avoid any revenue loss, however, by basing the cut on last year's 1.53 million barrels per day export level, which was about 10 percent higher than current levels. Moreover, because of Mexico's current high level of foreign exchange reserves, any oil revenue losses are unlikely to affect imports, debt negotiations, or other economic trends this year.

25X1
25X1
25X1

Impact of Oil Price Cut on British Finances

The recent cut in oil prices by British National Oil Corporation (BNOC) should have little effect on British tax revenues at current exchange rates. It has been estimated that for every $1 drop in British oil prices the Exchequer loses 60 cents in revenues, thus the $1.35 price reduction translates into a per barrel tax revenue loss of 81 cents. The price reduction affects only Britain's contracted sales because prices on spot-market sales of up to 500,000 barrels per day are already below the new official price. The revenue loss, however, is partly offset by the impact of the pound's depreciation. Since June, the price of oil in sterling has risen by almost 3 pounds per barrel, due to the fall in the exchange rate from $1.35 to $1.20. Depreciation of the pound acts as a built-in "revenue stabilizer" because oil is priced in dollars, boosting sterling earnings—and hence tax revenues. We estimate that the annual loss to the Exchequer will be $665 million. This represents only 0.5 percent of projected tax revenues.

25X1
25X1

Soviet Energy Embargo Against Britain

The USSR publicly indicated on Monday that to support the strike by British coal miners it will stop deliveries of oil and coal to the United Kingdom. A senior Soviet trade union official said the embargo would last for the duration of the strike, "regardless of the great sacrifices of currency." The embargo will have no effect on the UK's energy situation—the USSR provides less than 1 percent of total British energy supplies—and Moscow obviously intends it as a purely political gesture. It does have broader implications for the increasing dependence of Western Europe on Soviet energy supplies and the potential for the USSR to influence Western internal developments later in this decade. If the economic stakes were higher, Moscow might be more reluctant to make such a move, fearing being labeled an unreliable supplier at a time when it is trying to line up further sales of energy—mainly gas—to the West.

25X1
25X1

Iraq Pushes Turkish Pipeline Exports

[redacted]

Iraq pumped a record 980,000 barrels per day (b/d) of crude oil through the expanded Iraq-Turkey pipeline in October, [redacted] 25X1 enabling Baghdad to exceed its 1.2-million-b/d OPEC production quota by an estimated 100,000 b/d. Iraqi officials reportedly are planning to raise the 25X1 Turkish line's flow rate to 1.2 million b/d in January 1985 by more than doubling the use of drag-reducing chemicals. [redacted] 25X1 Meanwhile, Italy's Snamprogetti firm has been awarded the engineering-design contract for the second Iraq-Turkey crude oil pipeline, according to the US Interests Section in Baghdad. The $600 million project, scheduled to begin construction in July 1985 and to be operational by early 1987, will boost the system's export capacity by 500,000 to 600,000 b/d [redacted] Baghdad continues to push its crude oil exports to finance its economy and war effort, and has indicated it will seek a higher production quota from OPEC in 25X1 the future despite the weak oil market. [redacted] 25X1

UAE Plans for Strait's Bypass Pipeline

[redacted]

The UAE Government has decided in principle to build the Abu Dhabi–Fujeirah crude oil pipeline—providing an export route outside the Strait of Hormuz—according to the US Embassy in Abu Dhabi. The Abu Dhabi National Oil Company (ADNOC) has undertaken detailed site study plans and 25X1 is now preparing bid tenders. The 500,000-b/d pipeline reportedly could be completed in under 18 months and could carry onshore crude oil from Abu Dhabi's gathering center at Habshan to a new export terminal at Fujeirah. The projected high cost of the project, its vulnerability to Iranian attack, inter-Emirate squabbles, and the current underutilization of the Jebel Dhanna export terminal still present strong arguments against the project. [redacted] 25X1 While early construction of the line appears unlikely, political considerations and a suitable funding package could, in our view, override these doubts if an escalation of the Iran-Iraq war threatens UAE exports. [redacted] 25X1

[redacted] 25X1

Extension of Soviet Gas Pipeline in Finland

Moscow and Helsinki have signed a preliminary agreement for joint construction of a gas pipeline in Finland, according to the US Embassy in Helsinki. Final agreement will be reached later this year, and construction will begin in the first half of 1985. The pipeline will support additional Soviet gas exports to Finland. Annual Soviet gas sales to Finland would nearly triple—from about $90 million in 1983 to as much as $240 million in 1990, at current prices. Soviet hard currency earnings would not increase, however, because Finnish-Soviet trade is not conducted in convertible currencies. 25X1 25X1

International Finance

Mexican Spending Imperils IMF Targets

Mexico City's sudden increase in public-sector spending at midyear to stem the slide in living standards threatens to push the budget deficit well above the IMF program target for 1984. Data just released by the Bank of Mexico indicate that the increase is in part a result of higher subsidies for basic goods and services and increased government investment. 25X1 25X1 Mexico City is counting on IMF leniency because of its success in turning its foreign payments position around in the last two years. 25X1

The spending rise probably was designed to ease social tension and cultivate voters before nationwide elections next year. The government has failed to reinvigorate private investment and has kept consumer demand down by reducing real wages by about one-third in the last two years. Nevertheless, Finance Minister Silva Herzog hopes that higher government spending will result in a 2- to 3-percent growth in the economy this year. 25X1

Yugoslavia Proposes Multiyear Rescheduling

The US Embassy reports that Yugoslav officials proposed to representatives of 17 Western governments at a meeting in Belgrade that they reschedule debts coming due between 1985 and 1987 or, if possible, 1988. As in its proposal to Western banks, Belgrade is seeking a 10-year rescheduling period with five years' grace and lower interest rates than those contained in previous packages. The Yugoslavs also indicated that they want to avoid negotiating a new IMF standby program. The governments have proposed meeting in late November but will not conclude an agreement until an IMF standby program is in place. 25X1 25X1

Conclusion of multiyear rescheduling probably will prove difficult. Although commercial banks have voiced some support for the Yugoslav proposal, they will not conclude a deal until official creditors agree to a comparable rescheduling. The banks and governments are insisting on an IMF standby program because they doubt the probability of Belgrade's success in persevering with its adjustment program. Growing opposition within Yugoslavia to another IMF program is likely to prolong negotiations. 25X1

25X1

[redacted]

Mozambican Debt Rescheduled

[redacted]

Western governments have agreed in principle to reschedule $200 million in debt service payments owed them by Mozambique, according to press reports. 25X1
Terms will be negotiated bilaterally with each creditor government. [redacted] 25X1
[redacted] in addition to $1.2 billion owed to Western governments, 25X1
Mozambique owes $300 million to Western banks, which is to be renegotiated later. [redacted] 25X1

[redacted]

25X1

Global and Regional Developments

USSR and Libya Agree on Arms Debt

[redacted]

Moscow has reportedly agreed to reschedule Libya's large debt, with half of the amount to be repaid with oil at a reduced price. Libyan leader Qadhafi has decided to visit the USSR soon because the Soviets have agreed to consider his request for weapons. 25X1
In 1982 the Soviets allowed Libya to make payments on its multibillion-dollar military purchases with crude oil, which Moscow sold for hard currency at a discount price in the West. This deal could be extended—or possibly expanded—as part of another large arms agreement now being negotiated. If so, additional Libyan oil would appear on the world market, increasing pressure on OPEC prices. [redacted] 25X1

Progress on EC Enlargement

EC members last week overcame several obstacles to Community membership for Spain and Portugal in 1986, but the most contentious issues remain unresolved. The EC Foreign Ministers' meeting in Luxembourg on 23 October broke a four-month stalemate and agreed on proposals to curb olive oil production and to dismantle Spanish industrial tariffs after Spain and Portugal join the Community. The Ministers also reached a consensus on social security benefits for the families of Iberian workers and issued a declaration confirming that Portugal will join in 1986. 25X1 25X1

Lisbon and Madrid almost certainly will accept the EC's economic proposals at a negotiating session in mid-November. The meeting this week has rekindled hopes that the 1986 deadline for accession can still be met, but it did not address the more contentious issues of production limits for wine and Spanish fishing rights. Differences among EC members on these issues have yet to be resolved, and final negotiations with the applicants probably cannot take place before December. 25X1

US May Lose Foreign Partners to Airbus Industrie

In the wake of the huge Pan Am/Airbus agreement, both Japan and Italy are concerned about a perceived lack of commitment by US companies to an all-new 150-seat aircraft program to compete with the narrow-body Airbus A320. Both countries resisted pressure by Airbus to participate in the A320 program in favor of retaining traditional ties to US manufacturers. In March 1984, Japan, in a move to upgrade its aerospace technologies, signed an agreement with Boeing for a 25-percent risk share in a 150-seat aircraft if it were launched. Italy was counting on Boeing or McDonnell-Douglas programs to maintain employment in its aircraft sector. If no US program is available, Japan and Italy may find it hard to resist the pressures to join Airbus. Airbus Industrie has already approached Italy and Japan about participation in the proposed TA-11 program to develop a four-engine, medium-capacity, long-range airplane. 25X1 25X1

Quebec Makes Trade Deals With China

Quebec Premier Levesque's recent trade promotion trip to the Far East has provided new trade opportunities for several firms in the economically depressed province. The Quebec government claims that the Chinese authorities were eager to do business. Among the deals negotiated, a Montreal firm will supervise construction of a roasting oven for an aluminum plant. In addition, Hydro-Quebec—the provincially owned electric company—will continue its collaboration with the Chinese and conduct a feasibility study for a hydroelectric project on the Yangtze River. In a third deal, Bombardier signed a deal with the Chinese to assemble snowmobiles in China for use in patrolling the border with the Soviet Union. Bombardier also manufactures mass transportation equipment and sees possibilities for future deals with China. 25X1 25X1

National Developments

Developed Countries

French Economy Back on Track

French international payments adjustment seems to be back on track after a disappointing beginning early in the year. The seasonally adjusted trade deficit for the first three quarters of 1984 was less than $2.5 billion, down from the $5.5 billion deficit for the same period last year. Over the same period, the current account deficit dropped from $5 billion last year to less than $0.5 billion for the first three quarters of 1984. Both deficits make the recent government forecast appear pessimistic. The 12-month inflation rate also has shown a large improvement, falling to 7.1 percent compared with 10.1 percent in September 1983. More important, France has reduced its inflation differential with its major trading partners by about 2 percentage points over the past year. The government has held public-sector wage increases well below inflation. Despite these favorable signs and a continued rise in unemployment—up more than 1 percentage point in the last year to 10 percent—Prime Minister Fabius has warned that he will stick to austerity. [redacted]

25X1

25X1

UK Mine Foremen's Strike Averted

The decision last week by mine foremen to call off their strike is a blow to miners' chief Scargill. The strike, which would have forced the closing of the 25 percent of the mines still operating in the United Kingdom, apparently was averted by Coal Board concessions on pay and by indications of flexibility on mine closures. The foremen reportedly rejected requests from other unions to suspend the strike rather than call it off entirely. [redacted]

25X1

25X1

The apparent settlement with the foremen follows a refusal by electric power workers to support the miners. Most estimates indicate that the current level of operations could keep coal stocks from running down until early next year. If the Coal Board and the government demonstrate increased flexibility on the timing of mine closures, a settlement may be worked out. Scargill's eagerness to force a confrontation with Thatcher, however, probably means that only strong pressure from other unions or a return to work by more miners will force him to come to terms. [redacted]

25X1

Spanish Budget Proposal

The draft Spanish budget for 1985 reflects the Socialists' determination to maintain relative austerity. Higher taxes and lower real public-sector investment growth suggest lower domestic demand than Madrid predicts. The Gonzalez government is proposing several measures to cut the budget deficit from 5.5 percent of GDP this year to 5 percent next year. The real rate of increase in government spending will slow to 5.6 percent, down from about 10 percent this year. Growth of real public-sector investment will fall from 7 percent this year to 3 percent in 1985. Export subsidies will be cut, transfers to public-sector enterprises held constant, and government employees' real wages lowered by 1.4 percent. Spain's high unemployment rate and the Socialists' promises to increase unemployment-compensation coverage and finance a

25X1

larger share of social security, however, will push social security expenditures up 14 percent in real terms. Madrid is counting on increased taxes and measures to discourage fraud to boost real revenues 9.7 percent. [redacted] 25X1

Portugal's Talks With World Bank Stalled

[redacted] 25X1

Negotiations with the IBRD for a loan to restructure public-sector enterprises are proceeding slowly and may not be concluded until mid-1985, according to Embassy reporting. The Soares government originally sought Bank assistance in 1983 when it was suffering an acute foreign exchange shortage. Lisbon's brightening external outlook this year, however, has reduced its incentive to submit to the World Bank's condition. Although Lisbon recognizes the problems of the state sector, Portuguese officials are balking at Bank proposals for tying disbursements to the performance of three major state firms, for creating a ministerial council to manage public-sector companies, and for settling back debts to private-sector firms. Libson's mediocre track record on economic reform and the difficulty of carrying out politically unpopular austerity in 1985 as elections approach make us skeptical that the Portuguese would make much headway without pressure from the World Bank. [redacted] 25X1

[redacted] 25X1

[redacted]

25X1

Dim Prospects for Bangladesh's Economy

[redacted]

Bangladesh's fragile economy, which showed signs of recovery last year, has begun to falter. Recent flooding caused extensive damage to the rice crop—we estimate losses at over 1 million metric tons—and foodgrain production will probably stagnate in 1984/85 (July/June) while the population continues to grow at 3 percent per year. Although high world jute and tea prices will improve export performance, an expected sharp drop in foreign remittances and increased imports are likely to worsen its foreign payments problems, according to US Embassy reporting. Complicating the economic situation are loose monetary and fiscal policies, which have fueled inflation. Because of the deteriorating economy, we believe Dhaka will press for further economic aid from donor countries over the coming year. [redacted]

25X1

25X1

Brazil's Orange Juice Export Earnings Surge

[redacted]

Brazil's earnings from frozen concentrated orange juice (FCOJ) exports are expected to approach $1.1 billion in 1984, up 80 percent from 1983 earnings. Recurring production problems in the United States, continued growth in West European demand, and rapid development of Brazilian citrus production and processing have made Brazil the world's largest exporter of FCOJ. Brazilian exports in 1983 totaled 553,000 tons—80 percent of world trade in FCOJ—and earned a record $610 million, compared with exports of only 181,000 tons worth $82 million in 1975. About two-thirds of Brazil's orange crop goes to manufacture FCOJ almost exclusively for export. The US and EC markets account for about 80 percent of Brazilian sales. Strong world demand for Brazilian FCOJ is foreseen for the remainder of 1984 and 1985 as US citrus production in Florida struggles to recover from bad weather and disease. [redacted]

25X1

25X1

Threat of Famine in Uganda

[redacted]

Drought and military operations have led to serious food shortages in the Karamoja area of northeastern Uganda, renewing the threat of unrest in this perennially troubled region. Moreover, transport and administrative problems are delaying food aid distribution. As a result, deaths reportedly are increasing and people are beginning to move to resettlement centers in search of food.

25X1

The government, preoccupied with political infighting and a spreading insurgency near Kampala, has been unwilling to take on a famine-relief program, particularly in a politically out-of-favor tribal region. It therefore has made little effort even to move food from surplus areas. [redacted] 25X1

Communist

Annual CEMA Session

The annual meeting of CEMA heads of government begun this week in Havana probably will make little progress in implementing decisions made by party leaders at their summit in June. The agenda reportedly will focus on the issues of energy and raw materials. A plan for meeting the long-term needs of the member countries and for making efficient use of resources will be presented for approval. Specific proposals for cooperation in these fields through 1990 will be discussed. The delegations will also give progress reports on coordination of their 1986-90 economic plans. [redacted] 25X1 25X1

Although bilateral and CEMA commission meetings have discussed the summit decisions, the sparse agenda suggests only limited progress in resolving CEMA's problems. The energy plan probably involves a Soviet effort to win Eastern Europe's commitment to a proposed new gas pipeline and to investing in Soviet energy and raw materials development, but it will not address future Soviet oil deliveries to CEMA and pricing arrangements. A program for scientific-technical cooperation in CEMA, which was to be drafted after the summit, apparently is not ready for consideration. This meeting also may take a milder tone on East-West trade than the session last year, when Soviet Premier Tikhonov warned about the dangers of trading with the West. [redacted] 25X1

Soviet Cutback on Exports of a Strategic Mineral

[redacted] the Soviets have reneged on several contracts for the export of chrome ore worth $4 million on the world market. As of late September, the cutbacks reached an estimated 50,000 tons—roughly 10 percent of Soviet exports in 1983. Japan, which depends on the USSR for about 10 percent of its chrome ore imports, has been forced to turn to other suppliers. [redacted] 25X1 25X1 25X1

The Soviets traditionally have been scrupulously reliable suppliers of chrome ore. These cutbacks are probably related to mining problems—chrome ore production has been limited by mine depletion, declining ore grades, and the change from open pit mining to more expensive underground mining. Increased internal demand for stainless steel, however, may also figure in the reduction in exports. [redacted] 25X1

USSR-China Trade Talks Imminent

A Soviet trade delegation plans to visit China soon to negotiate the bilateral annual trade agreement for 1985. Both Soviet and Chinese officials are reported to be optimistic about the prospects for another substantial expansion of trade next year. In 1984, two-way trade is targeted to nearly double the 25X1

$650 million level of 1983. In the first six months of 1984, turnover with China was roughly $500 million—more than triple the comparable level of the previous year. The trends underscore mutual efforts by Moscow and Beijing to improve economic relations in spite of political differences. 25X1

China To Sell US Timber in Japan

25X1

China International Trust and Investment Corporation (CITIC) has begun logging operations in Washington state, where it holds the cutting rights on three large tracts of timber. A CITIC official informed Embassy Beijing that although most of the logs would be used in China the best grades would be sold in the Japanese market. Japan has long been a purchaser of high-grade West Coast logs, and Chinese sales of US-cut timber in Japan probably will reduce direct West Coast sales. Over the past few years, China has greatly increased its purchase of West Coast logs. A major West Coast log-exporting port reported shipping 299 million board feet (mbf) to China and 243 mbf to Japan in 1983, compared with 83 and 194 mbf, respectively, in 1981. 25X1

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000707260001-0

OPEC Financial Troubles: Broader Ramifications [redacted] 25X1

Since the shift in the world oil market after 1979 to oversupply and sagging prices, the plunge in OPEC countries' oil earnings has forced uncomfortable financial adjustments. Oil revenues declined from a peak of $275 billion in 1980 to $154 billion last year, and our calculations suggest revenues will rise only slightly this year. Beyond the impact on the economies of the members, the revenue loss is beginning to have broader ramifications for OPEC cohesiveness, Third World debt, Soviet-OPEC relations, and international aid flows. [redacted]

Financial Impacts

The decline in revenues over the past several years has led to a deterioration of OPEC's current account, a cutback in imports, a drawdown of foreign assets, and a reduction in OPEC aid:

- OPEC's current account—in surplus by $109 billion in 1980—registered a $22 billion deficit last year, according to our estimates. Saudi Arabia, because of its role as swing producer, has absorbed most of the production cuts and recorded the largest deficit—$17 billion. We project an OPEC current account deficit of $11 billion in 1984, and Riyadh's deficit will approach $14 billion.

- We estimate that OPEC countries—primarily Saudi Arabia, Iran, and Iraq—drew down $28 billion in official assets in 1983. In addition, Indonesia, Algeria, Saudi Arabia, Nigeria, and Ecuador borrowed $3.5 billion from commercial banks and the IMF.

[redacted]

- OPEC import volume dropped 11 percent in 1983 and probably will decline another 5 percent this year. This contrasts markedly with average annual increases of 15 percent during 1981-82.

- Major OPEC aid donors cut disbursements to LDCs last year by nearly $5 billion to $6.5 billion. [redacted] 25X1

Pressures on the Cartel

25X1

The financial bind the soft oil market has imposed on most OPEC states is becoming an increasing threat to the cohesiveness of the organization itself. The dramatic drop in oil consumption in the past few years has caused substantial price weakness and forced OPEC to behave like a true cartel. Nonetheless, financial pressures have periodically forced members to exceed their production quotas by offering discounts or bartering oil. Only a sharp production cut by Saudi Arabia this past July averted another price decline stemming from such discounting actions and temporarily reaffirmed the cartel's commitment to defending oil prices. [redacted]

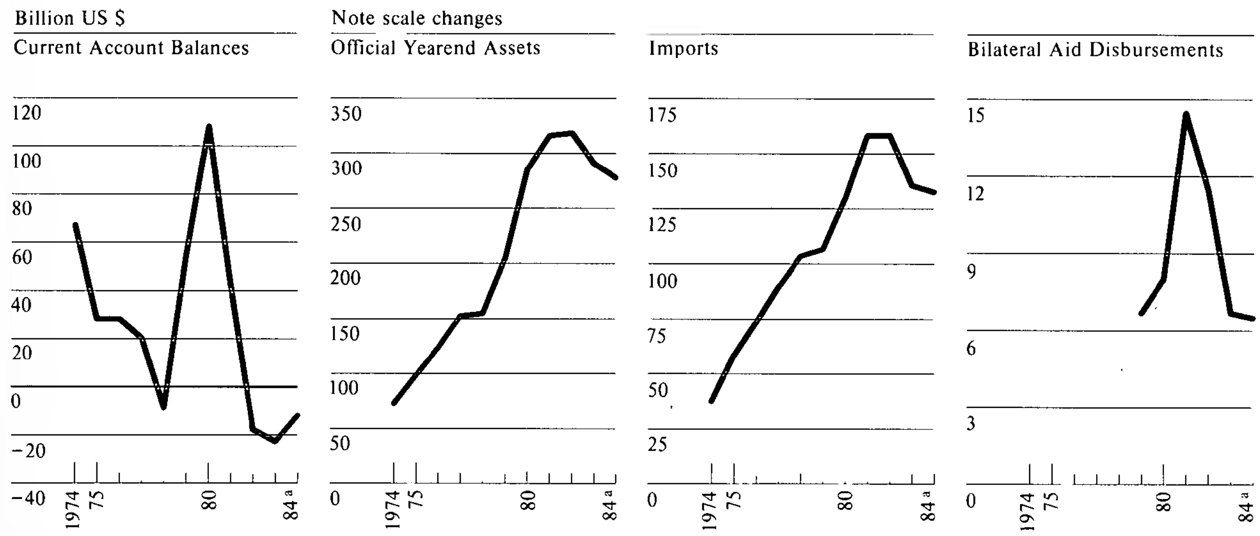
25X1

The recent price declines present yet another threat to OPEC unity. Some slippage in discipline already is occurring:

- Nigeria has cut prices to boost its sales and ease pressing debt and economic problems. 25X1
- Marketing problems have forced Algeria to sell crude by offering discounts, [redacted] 25X1

25X1

OPEC Countries: Foreign Accounts, 1974-84



[a] Estimated.

303936 (C00486) 10-84

25X1

- Libya is exploring barter arrangements with a greater number of Western suppliers,

25X1

The LDC Debt Problem

The prolonged weak oil market has added three OPEC countries to the long list of LDCs unable to service their debt. After financially extending themselves during the oil price runup period, Nigeria, Venezuela, and Ecuador were unable to absorb the loss in oil revenues and stay current with their debt repayments:

- According to our estimates, Lagos has $8-10 billion in officially guaranteed and unguaranteed trade arrearages. While many uninsured creditors have accepted Lagos's refinancing offer of six-year promissory notes, official creditors remain reluctant to implement a restructuring without an IMF-supported program in place.

- Large-scale capital flight sparked by a concern about lower oil revenues and the overvalued bolivar led the Venezuelan Government to postpone principal payments on public and private debt in March 1983. A self-imposed austerity program has received favorable comment by IMF representatives, and, as a result, bankers have recently concluded a provisional debt-restructuring agreement without the usual prerequisite for a formal IMF agreement.

25X1

- Ecuador negotiated an IMF-supported adjustment program and a financial package with creditor banks last year that included debt restructuring and a new $430 million line of credit. The one-year standby expired in July, and recently inaugurated President Febres-Cordero is negotiating a new program as well as a 1984 debt-refinancing package with bankers. 25X1

Algeria and Indonesia so far have been able to continue to meet their debt obligations and maintain fairly good credit ratings—largely because of their more diversified export bases and quicker implementation of austerity measures in response to the oil-revenue decline. Financial strains are evident, nonetheless, and if the oil market remains weak or there is a further runup in interest rates, their creditworthiness could quickly erode. Jakarta will have difficulty boosting nonoil exports this year, while Algeria's natural gas sales are sluggish.

Political Fallout

The austerity measures imposed in many of the oil-producing countries have sparked public criticism of government mismanagement and corruption. The change of governments in Nigeria and Venezuela last year was due in part to discontent over economic conditions. Moreover, the new governments in these two countries are continuing to face political difficulties. Venezuelan President Lusinchi's ability to implement his austerity program hinges on maintaining a fragile social pact with business and labor. Failure of the 10-month-old Buhari government to revive Nigeria's economy as promised is straining the already delicate fabric of the armed forces. The government is reluctant to implement extensive reforms and austerity measures for fear of being ousted by disgruntled soldiers.

In Indonesia, President Soeharto is risking popular backlash against austerity policies. For the Iranian and Iraqi Governments, heavy war expenses and lower oil revenues have combined to produce consumer shortages, making it more difficult to maintain popular support for the prolonged war.

25X6

Generally, the economic adjustment and political fallout have been less severe for those OPEC members with substantial foreign assets, smaller import requirements, and small populations; these governments have been able to maintain generous subsidies and welfare programs that help insulate the citizens from the impact of spending cuts. Nevertheless, the sharp contraction in domestic liquidity has taken a heavy toll on financial, real estate, and construction sectors and generated disgruntlement among businessmen and members of the ruling families with substantial income from these sectors:

25X1

25X1

- In Kuwait, liquidity constraints have helped delay a comprehensive and final settlement of the 1982 Suq al Manakh stock market crash, which touched off private capital flight and a drain on foreign assets.

- In the United Arab Emirates, the banking sector has been hard hit with the failure of a major institution last year and a large number of loans to near-bankrupt construction companies. 25X1

25X1

Reduced Aid

Over the past decade, the wealthier OPEC members have considered aid a major foreign policy tool to promote their influence in the Third World and in international forums. Feeling the pinch of OPEC's reduced aid disbursements, major recipients are looking for other donors to make up the loss and in the process are willing to strain relations with their more traditional Gulf donors. For example, we judge that Syria is tilting toward Tehran in part to offset the $1 billion in aid lost from Saudi Arabia and Kuwait last year. Reduced international aid flows were a principal motive for Moroccan King Hassan's recent union with Libya. 25X1

25X1

In the case of Jordan, Pakistan, and Sudan, the cutbacks have resulted in increased pressure on Washington for additional assistance. The United States has strategic interests in these countries and

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000707260001-0

reduced financial inflows could lead to increased instability and foreign meddling by Libya in Sudan. In addition, the Saudis may be less willing to use foreign aid in ways that dovetail with US policy interests.

Increased Soviet Contacts

The sharp drop in OPEC's share of the oil market continued price pressures, and financial problems created by these conditions have led the cartel to seek the cooperation of a number of other producers, including last year the first formal contact with Moscow. OPEC members had become concerned that aggressive Soviet pricing and growing exports to Western countries were undermining the cartel's ability to stabilize prices.

As long as the market remains weak, we believe OPEC members will continue to seek contacts with the Soviets, to gain support for their pricing structure. On the barter scene, Moscow is unlikely to be able to exert any political leverage over OPEC members with whom it has special oil-supply relationships. Furthermore, we believe that Soviet efforts to maximize hard currency earnings will make Moscow unwilling to adopt an oil export policy that would support OPEC price guidelines.

Outlook

We do not expect any early improvement in OPEC's financial position. We now project a $12 billion current account deficit in 1985, assuming no further unraveling of the price structure and a slight rise in demand for OPEC oil. Given the financial problems of many OPEC countries, we expect imports will grow slower than exports, but calculate that the small improvement in the trade balance will be offset by a larger net services deficit.

Even under this price scenario, OPEC members will be forced to continue politically difficult economic-adjustment policies:

- We are most concerned with the ability of the Nigerian Government to contain the political fallout from its financial crunch.
- A resurgence of ethnic and religious tensions is contributing to antigovernment sentiment in Indonesia.
- In Venezuela, economic stagnation could intensify strains between business and workers and disrupt Lusinchi's consensus for his austerity program.

25X1

25X1

Moreover, if oil prices decline in the months ahead, the problems for OPEC countries would become more acute. In particular, an oil price decline would cause serious financial problems for major OPEC debtors—Nigeria, Venezuela, Indonesia, and Ecuador—as well as non-OPEC debtors such as Mexico and Egypt. These debtors could opt to suspend debt service payments to reduce foreign exchange outflows and preserve dwindling export earnings.

25X1

25X1

A sustained soft oil market over the next few years could even have substantial political repercussions for the wealthier OPEC members. Press accounts indicate that Riyadh is assuming that demand in the world oil market will recover substantially in 1986. This is contrary to expectations of many private petroleum analysts. If they are correct, wealthier OPEC members will come under growing pressure to adopt more stringent policies to control spending and stem the drain on foreign assets. We believe the Saudis and others are not prepared for any sustained economic reversals.

25X1

25X1

25X1

25X1

Major LDCs: Financial Impact of an Oil Price Decline

25X1

The decline in world oil prices is introducing additional uncertainty into the financial outlook for LDC debtors. A $2 per barrel drop would have only moderate effects on most LDCs. If a major decline in oil prices occurs, however, oil-exporting debtors will face substantial reductions in their export earnings that would impair their ability to meet debt obligations. On the positive side, oil-importing countries would realize savings on their oil bill.

Foreign Trade Impact

With a decline in oil prices, LDC oil exporters such as Indonesia, Mexico, Nigeria, and Venezuela would find themselves with less foreign exchange to meet their import spending and debt service obligations. South Korea, Brazil, the Philippines, and other oil-importing debtors would be able to increase imports of nonoil goods and perhaps improve their debt service record. The foreign trade impact would not end here, however, because any oil price decline would start up a global adjustment process that would involve further trade shifts and require probably two or more years to work out. These secondary effects probably would work in favor of most debtors as lower prices stimulate OECD real growth and import demand.

To quantify the impact of oil price declines on key debtors, we calculated the dollar impact of two scenarios: a price reduction of $2 per barrel to a benchmark price of $27—roughly representing the current decline—and a reduction to $20 per barrel—representing a major decline. We are assuming across-the-board cuts in oil prices even though prices for different types of oil may not change uniformly. Moreover, to simplify analysis, we assumed that export and import volumes will stay constant at 1984 levels.

25X1

The Losers. If prices declined only $2 per barrel, we anticipate that only Egypt and Nigeria would experience increased financial problems. Egypt's oil earnings would fall by $160 million, and Nigeria's losses would be roughly $800 million, about 5 percent of total export earnings for each. With a price drop to $20 per barrel, however, almost all oil exporters would face serious problems. The revenue losses of Mexico would be $5 billion, 20 percent of total exports, while losses in Nigeria and Venezuela would amount to roughly $4 billion each, representing 25 percent of their respective export totals.

25X1

25X1

Oil-exporting countries essentially would have four options for adjusting to these revenue losses:

- Cut imports.
- Draw down foreign exchange reserves (including foreign assets).
- Increase foreign borrowing.
- Delay foreign debt service payments (run arrearages).

In most cases, countries would choose some combination of these policies, depending on their credit standing, foreign exchange reserve level, and ability to manage import cuts. Thus, such troubled debtors as Mexico and Nigeria probably would have little success in borrowing additional new funds unless official assistance was provided. At the same time, according to press reports, Mexico has foreign exchange reserves of about $7 billion and Venezuela of $12.5 billion, which could provide a cushion if

25X1

25X1

Major LDCs: Impact of Alternative Oil Price Declines

	Net Oil Exports, 1984		Impact of Oil Price Declines on Trade Balance *(million US $)* [a]	
	Thousand b/d	*Million US $*	$2 per barrel	$9 per barrel
Argentina	5	52	NEGL	−20
Brazil	−456	−4,790	330	1,500
Chile	−67	−700	50	220
Ecuador	145	1,300	−110	−480
Egypt	218	2,200	−160	−720
Indonesia	934	10,000	−680	−3,070
Mexico	1,550	15,275	−1,130	−5,090
Nigeria	1,120	12,800	−820	−3,680
Peru	50	525	−40	−160
Philippines	−200	−2,100	150	660
South Korea	−550	−5,720	400	1,810
Venezuela	1,298	13,300	−950	−4,260

[a] Estimated.

25X1

desired. Debtors with limited foreign exchange holdings would probably opt for some combination of import cutbacks and arrearages on debt payments. For countries that have low reserves and that already have made substantial reductions in imports, delaying debt payments is the likely course of action.

Debtors with excess oil-productive capacity would have the additional option of increasing their oil exports, although such a move would almost certainly put additional downward pressure on prices. Of the major LDCs, Nigeria currently has about 500,000 barrels per day (b/d) of surplus productive capacity and Venezuela and Indonesia each have about 100,000 b/d.

The Winners. Those LDCs heavily dependent on oil imports would realize substantial savings if oil prices declined. Brazil and South Korea each would save $300-400 million annually under a $2 per barrel price decline, and about $1.5 billion each under a $9 per barrel price decline.

The net oil importers would have favorable options available. Two major ones are:

- Government revenues could be raised almost painlessly by imposing an oil import tax that matched any price decline. Revenue-short governments, especially in Brazil and the Philippines, could find this tax policy attractive. Domestic oil prices would be maintained, thus not disturbing investment projects and energy-consumption patterns predicated on a roughly $30 per barrel oil price. 25X1

- Alternatively, some countries could choose simply to pass on the full oil price reduction to their domestic economies, allowing greater imports of other goods. At the same time, the decline in oil prices would boost oil consumption and encourage a greater volume of oil imports, especially after an adjustment period of several years. 25X1

25X1

25X1

Second-Order Effects. In our judgment, LDCs that sell substantial amounts of goods to oil-exporting countries could find markets in these countries diminishing following an oil price decline. At the same time, however, markets in the oil-importing countries, including most of the OECD, would be expanding with the increased purchasing power of consumers in those countries. Thus, although initially exports to the oil producers might drop faster than new exports to oil-importing countries would increase, after a year or two we believe the favorable trade-boosting impact would more than compensate for any decline. Although the diverse composition of LDC exports makes it difficult to assess which countries would benefit most from this impact, export-oriented economies such as South Korea and Brazil would be in the best position to take advantage of this increased demand. [redacted]

Interest Rates. An oil price decline could help bring down interest rates. Over the longer run, interest rates reflect real supply and demand conditions for credit as well as the anticipated rate of inflation. A falling oil price would reduce the component of interest rates that reflects future inflation. Some analysts have predicted that a $2 per barrel oil price cut would lead to a 1-percentage-point drop in interest rates. In this case, all LDCs would gain, particularly those with a proportionately large share of their debts at floating interest rates, such as Argentina, Brazil, Mexico, and Nigeria. [redacted]

Major Debtors: Net Savings of a 1-Percentage-Point Interest Rate Decline [a]

Million US $

Argentina	310
Brazil	780
Chile	130
Ecuador	50
Egypt	30
Indonesia	50
Mexico	710
Nigeria	120
Peru	50
Philippines	130
South Korea	220
Venezuela	210

[a] These data are derived from the change in the portion of net debt (gross debt less deposits) pegged to floating interest rates.

25X1

[redacted] 25X1

Implications

We believe lower oil prices would on balance contribute appreciably to a more robust world economy, especially after an adjustment period of several years. OECD growth would be promoted, and interest rates probably would ease. Some LDC debtors that depend heavily on oil exports, however, would be in a much more precarious financial situation, particularly if an oil price decline was substantial. Egypt and Nigeria are especially vulnerable because of their lack of maneuvering room; Egypt has few alternative exports, and Nigeria has large arrearages and dwindling foreign exchange holdings. [redacted]

The risks of a moratorium on debt service payments by one or more of these countries thus would increase if oil prices plummeted. Initially, these countries probably would run greater arrearages and also attempt to negotiate much improved debt terms and new credit. Private creditors, however, would be very reluctant to extend new loans after a fall in oil prices. We believe only relatively small amounts of new lending would be forthcoming as creditors attempted to protect outstanding loans. 25X1 [redacted] 25X1

Disruptions to the international financial system from lower oil prices also could stem from countries that are less dependent on oil earnings. For example, Peru and Argentina already are in desperate financial straits. Even a small reduction in their export earnings, which would follow an oil price decline, could push them closer to a moratorium on all debt payments. [redacted] 25X1

A decline in oil prices would not be enough to substantially ease the debt problems of oil-importing LDCs. Most of the larger debtors—particularly

25X1

Impact on Individual Oil Exporters

Mexico *would be hit hard by lower oil revenues, largely because the country still has little room to maneuver. Imports have been cut to the bare minimum over the past three years, and nonoil exports—although growing—would not be able to pick up the slack generated by large oil revenue losses. Mexico recently reached preliminary agreement with its bank advisory committee on a debt restructuring, but the package must still be signed by all creditor banks. A small drop in oil prices could be absorbed by Mexico because some cushion has been built into the restructuring package; a large price decline, however, would pose serious problems. Many banks—some of which are already reluctant to participate in the restructuring—could find it even harder to justify their participation. Should oil prices drop to $20 per barrel, Mexico might not be able to meet its interest payments, adding strains to the world financial system.*

Venezuela *probably would be able to absorb a small drop in oil prices because of its relatively better financial position. Foreign exchange reserves remain high, and the recent restructuring package with commercial banks will reduce debt service requirements over the next several years. The package probably will be signed by the individual banks because of its overall benefits for both creditors and debtor. Banks, however, could be reluctant to participate in new loans over the medium term should Venezuela not take actions such as drawing down reserves to make up for the loss in oil revenues.*

Indonesia *also would be able to adjust to a small price decline, although at some cost to its economic growth prospects. Because Jakarta could not expect much help from nonoil exports, the government might reduce spending on development projects as it did in 1983. This in turn would reduce imports of capital and intermediate goods, which would offset the loss in oil revenue. Foreign exchange reserves also provide a cushion in the near term. Even with a sharp drop in oil prices, Indonesia would not have immediate debt repayment problems because of the favorable structure of its repayment schedule. Moreover, creditors probably would respond favorably to an Indonesian cutback in spending so that the country's credit rating would not be severely altered.* 25X1

Egypt *could be hard hit by falling oil prices because of its precarious financial situation. Banks currently view Egypt as a below-average credit risk, and a loss of oil income—which accounts for over 60 percent of exports and over 20 percent of exports of goods and services—could lead to debt repayment difficulties. We believe Cairo would press the United States even harder for debt relief on Foreign Military Sales credits and might have to seek rescheduling from other private and official creditors. A significant reduction in prices could also interrupt Egyptian oil-exploration efforts, hindering the future growth of oil production. Moreover, deepening financial problems in Persian Gulf countries could reduce the need for Egyptian migrant labor.* 25X1 25X1

Nigeria *currently is under serious financial strain. Lagos has major-debt servicing problems, with a large buildup of arrearages on short-term debt and dwindling foreign exchange reserves. If its recent oil price cut is maintained, the annual loss in export earnings will be some $800 million, according to our estimate. Reduced oil revenues would put increased pressure on Lagos to cut spending and reduce imports and to reach agreement with the IMF on a standby arrangement. The impasse with the Fund probably will continue through yearend, however, because of the government's unwillingness to implement a devaluation.* 25X1 25X1

Ecuador *probably would be able to absorb a small drop in oil prices. Quito is close to reaching a new standby arrangement with the IMF, which will be followed by bank negotiations on a debt restructuring and new money. Ecuador's economic team has been cooperative with the IMF and will probably take the steps necessary to adjust to lower oil export revenues. A large fall in oil prices, however, could make creditors reluctant to provide new money, since some banks already are balking at increasing their exposure.* 25X1

in Latin America—are unable to attract any new lending from foreign creditors outside of their debt-restructuring packages. Moreover, capital flight remains a problem as does a lack of foreign direct investment. Still, to the extent that faster OECD growth and a decline in interest rates result from a lower oil price, the combination could lead to some easing of financial pressure. [redacted] 25X1

We expect creditors to look at the oil-importing LDCs more favorably in the event of lower oil prices, but this could be overshadowed by lender concern for the financial situation of the major oil-exporting debtors. Mexico, in particular, would attract lender attention because of the size of the country's debt and the implications for the international financial system as a whole. Thus, the overall positive impact on oil-importing LDCs probably would be realized more over the medium term than in the short term. [redacted] 25X1

[redacted] 25X1

Chile: Looming Payments Problems [redacted]

25X1

Chile's current IMF program is coming unglued, and mounting current account problems could force a suspension of debt service in coming months. External factors—lower-than-anticipated copper prices and higher-than-expected interest rates—and an overly stimulative economic growth program instituted by Santiago this spring share the blame for Chile's predicament. Recent government actions to slow import growth came too late to have much impact on the $500 million foreign exchange shortfall we anticipate this year. [redacted]

Santiago wants the IMF to accept some adjustments to its current program and to negotiate a new agreement for next year, but problems are jeopardizing any quick resolution on either front. In any case, bankers appear unwilling to provide the level of new lending Chile believes it needs. This leaves the government with the choice of either slowing the economy—which could fuel increased political opposition—or suffering the gradual loss of critical imports as foreign lending dries up. [redacted]

Problems With the IMF Program

Chile's IMF-supported program for 1984 appeared to lay the basis for a rebound in economic growth and improvements in its payments position. It allowed Santiago to double its budget deficit to 4.6 percent of GDP to help spur economic growth and reduce unemployment, and assumed foreign exchange availability would increase. The program anticipated that copper prices would rise to 75 cents per pound, boosting export earnings by 5 percent, and that a stable US prime rate would hold interest payments in check. [redacted]

The first cracks in this plan occurred in March, when falling copper prices and rising interest rates began to cut into Chile's ability to finance imports.

Chile: Balance of Payments *Million US $*

	1983	1984 Assumptions Under IMF Program [a]	1984 CIA Projections
Current account	−1,068	−1,250	−1,850
Trade balance	1,014	1,000	500
Exports (f.o.b.)	3,850	4,150	3,950
Imports (f.o.b.)	−2,836	−3,150	−3,450
Net services and transfers	−2,082	−2,250	−2,350
Interest	−1,600	−1,700	−1,800
Other	−482	−550	−550
Capital account	513	1,250	1,350
Foreign financing	2,386	1,940	2,040
IMF	495	238	238 [b]
Bank lending	1,300	780	780 [b]
Net direct foreign investment	152	160	100
Other	439	762	922
Amortization on debt	−1,873	−690	−690
Foreign exchange gap	**555**	**0**	**500**

[a] January 1984.
[b] Should Chile be found out of compliance with its IMF-supported program in November, banks could suspend $190 million in lending, and the IMF could withhold $108 million in credits.

[redacted]

25X1 25X1 25X1 25X1

Hopes for holding unemployment under 12 percent diminished as tight domestic credit continued to hurt private-sector expansion. At the same time, the political and labor opposition movement resumed its protests following the traditional December-March "summer" recess, and Pinochet felt obliged to respond by installing a new economic team that advocated greater growth.

Payments Stresses Materialize

The new economic team immediately took steps to spur a strong economic recovery. In mid-April, Finance Minister Escobar increased public investment in housing, mining, and infrastructure improvements to reduce unemployment. In May, Escobar eased domestic credit by injecting liquidity into the crippled banking sector. According to US Embassy estimates, this bank bailout would cost Santiago $1 billion or 5 percent of GDP over the next 12 months. The government also offered new subsidies to promote domestic manufacturing and agricultural production, to spur import substitution and export growth.

Santiago succeeded in boosting GNP growth to nearly 7 percent in the first half of 1984, but the expansion took its toll on foreign exchange availability. Imports surged 23 percent in the first half over the same period in 1983, while export growth slowed to 1 percent. The $360 million trade surplus during January-June was only half that of the first six months of 1983. The IMF—alarmed by these developments—refused Chile's request for relaxation of its budget deficit target. Escobar suggested to lenders that additional lending, beyond the $780 million that Santiago and the banks had agreed on, would be needed to sustain growth.

Averting Cash Strains

Chile's economic team has had to tap a wide variety of sources of external financing to meet growing payments problems. Chile drew $512 million of its IMF and bank credits in the first half of 1984.

According to IMF reports, Chile was able to achieve its IMF target of no reserve drawdown only by offering domestic financial and commercial institutions premium interest rates to repatriate foreign assets. The Central Bank, by arranging short-term swap agreements with these institutions, garnered $340 million.

Although these moves kept Chile in technical compliance with IMF reserve targets, bankers turned a deaf ear to Escobar's request for $500 million in additional credits. According to US Embassy reporting, Chile's bank advisory committee chairman threatened in August to withhold nearly $200 million in promised credits if Chile fell out of compliance with the Fund agreement. Without new credits, Escobar suggested Chile would need to draw down $300 million in foreign exchange reserves by the end of the year. The US Embassy reported that Santiago already had begun dipping into reserves in July, and had drawn down $150 million in reserves in July-August.

Santiago has responded slowly to IMF calls for austerity, fearing that such moves would provoke greater political and labor opposition to the government. Instead, the government is trying to slow imports by implementing higher tariffs. In July, for example, the economic team raised tariffs on luxury goods—making up 6 percent of imports—from 20 percent to 35 percent. After antiregime protests in September failed to gain momentum, Chile took additional steps to ease payment strains and adhere to its IMF program. Escobar announced a 24-percent devaluation and established a 35-percent uniform tariff—up from an average tariff level of 21.4 percent. Additionally, he suspended scheduled tax cuts to shore up government revenues, and he promised to tighten public spending.

A Rough Fourth Quarter

Despite the devaluation and tariff increase, we believe Chile could experience a foreign exchange shortfall of $500 million by December. Low copper

prices probably will reduce expected export revenues by $200 million this year. In addition, interest rate hikes could add $100 million to debt service costs. [redacted]

Failure to comply with Fund targets may cause bankers and the IMF to suspend undrawn credits. Although Santiago already is drawing down reserves, the IMF has yet to sanction these moves. If Santiago is found out of compliance with its IMF program during the early November review, and if bankers in turn withhold nearly $200 million in fourth-quarter credits, this would increase the Chilean payments shortfall to over $800 million. If neither the IMF nor the banks relent, Chile will be forced to suspend debt servicing. [redacted]

We believe a payments suspension by Chile—known in the past for its faithful debt servicing—would be directed mainly at holders of private-sector debt. According to US Embassy reporting, Escobar has stated that in the event of a foreign exchange shortage, interest on the public debt will be paid, but the private sector will have to fend for itself. Santiago also could implement exchange controls on private-sector external payments by 1985. [redacted]

Repercussions for 1985

Chile's efforts to improve its payments balance will cause the economy to languish in the first half of 1985. According to US Embassy estimates, each 10-percent decrease in imports causes economic growth to slow by 2.5 percentage points. Economic growth could drop below 3 percent in the fourth quarter once the impact of the devaluation and tariffs begins to slow imports. Escobar is asking bankers to lend Chile $1.5 billion in 1985—which we estimate would support at least 3-percent real GDP growth—but we judge that because of regional bank reluctance Santiago will receive new credits of $700 million or less, holding economic growth to 2 percent or less for the year. [redacted]

Downside Risks

If Chile fails to conclude a new IMF program before January, economic growth next year could be further reduced. This could delay rescheduling of $2.2 billion of principal due in 1985, forcing Chile into arrears. New commercial lending also would be suspended, leaving Santiago to rely on its dwindling reserves to cover essential imports. In this case, Chile's economy would slip back into recession. [redacted]

Pinochet's efforts to shore up the external accounts could also undermine his ability to redress popular discontent. The coming December-March vacation period will blunt adverse political reaction to the recent devaluation and tariff increase. A prolonged foreign exchange squeeze, however, would increase business failures and unemployment—conditions that last year helped unite Chile's disparate opposition factions. [redacted]

We believe Pinochet would try to relieve pressure with progressively more nationalistic economic policies aimed at boosting domestic manufacturing. Santiago might again relax fiscal discipline, increase public spending, provide new credit and consumer subsidies, and introduce higher tariffs. We judge Pinochet would also consider tightening foreign investment laws to placate economic nationalists. Such changes would lead to economic stagnation, rapid inflation, and persistent payment constraints. [redacted]

Implications for the United States

Chile imported $250 million worth of goods from the United States during January-April 1984—a 22-percent increase over the same period last year—with capital goods and chemicals constituting 60 percent of the total. The higher tariffs and recent devaluation will moderate these gains sharply in the months ahead. Moreover, Santiago's

increased emphasis on import substitution could restrict access to Chilean markets. [redacted] 25X1

Chile's suspension of debt servicing would sour relations with the IMF and bankers, thus delaying a new Fund program, debt rescheduling, and new commercial lending. Escobar has suggested that the upshot of this would be an increase in Chile's need for debt relief beyond the five-year grace period on principal payments. The impact of a Chilean debt-servicing suspension could also extend beyond the $5.5 billion in Chilean debt that US banks hold by encouraging other Latin debtors to press for increased politicization of the issue. [redacted] 25X1

[redacted] 25X1

West Germany: Obstacles to Growth 25X1

West German manufacturers have lost some international competitiveness since the early 1970s as a result of sluggish investment, declining productivity, and tardy adaptation to changing markets, especially in high technology. Overall, West Germany has seen its share of the world exports (excluding oil) drop from a high of 15 percent in 1970 to 13 percent in 1982. Although all major Western countries have experienced share losses due to the export success of Japan and the newly industrialized countries, these trends have shaken the confidence of industry. Although West Germany's standing as a major economic power behind the United States and Japan is not in jeopardy, the technological and structural gap that has opened will not be closed soon. 25X1

Troublesome Trends

West German investment has been anemic since 1970. In real terms, it grew on average only 1.5 percent per year during 1971-79 before falling sharply during the recession in the early 1980s. Among Big Seven countries, only Italy and the United Kingdom did worse, while US and Japanese investment grew more than twice as fast. Real gross fixed investment in West Germany in 1983 was just 10 percent higher than the 1970 level, whereas Japanese, US, and French investment grew by 58,45, and 28 percent, respectively. 25X1

Although West German technology remains among the most advanced in the world, some key sectors have not kept pace with developments in Japan and the United States:

- In microelectronics, West Germany's electrical engineering trade association has concluded that the country's third-largest industry is falling behind industries in the United States and Japan. West Germany has been unable to develop a successful mainframe computer industry and has ceded its dominance of the European consumer electronics market to France and Japan. It lags by far the United States and Japan in the use of integrated circuits, and is weak in software for information processing.

- West Germany has lost the technological supremacy it held in machine tools in the 1960s and dropped 10 percentage points in its export market share (equal to Japan's gain) since 1973.

- Japan is challenging West Germany in fiber optics, precision forging technology, medical electronics equipment, and advanced metalworking equipment.

- West Germany lags the latest developments in biochemistry, high-tech metals and materials, and advanced telecommunications. 25X1

Factors Behind the Weakness

Observers of the West German economic scene have proposed numerous explanations for West Germany's industrial problems:
- West German industrialists are "coasting" on their reputation and not investing in the future.
- The vaunted German work ethic has eroded.
- The weak financial position of West German firms is retarding economic change.
- The Bonn government, with a growing web of taxes and administrative regulations, is increasingly an obstacle to innovation and entrepreneurship.

25X1

- A massive social benefits system tends to discourage worker "sacrifices" for the economy and to squeeze company profit margins.

"Coasting." The very success of West German industry in postwar decades is today a handicap to competing in a period of rapid technological change, according to a number of industry observers. West German industrialists developed an overconfident, even arrogant attitude toward foreign competition after being so successful for so long with existing product lines. For example, photography industry experts say Japan completely displaced the top West German manufacturers in the amateur photography equipment market because they resisted incorporating new technology in their products.

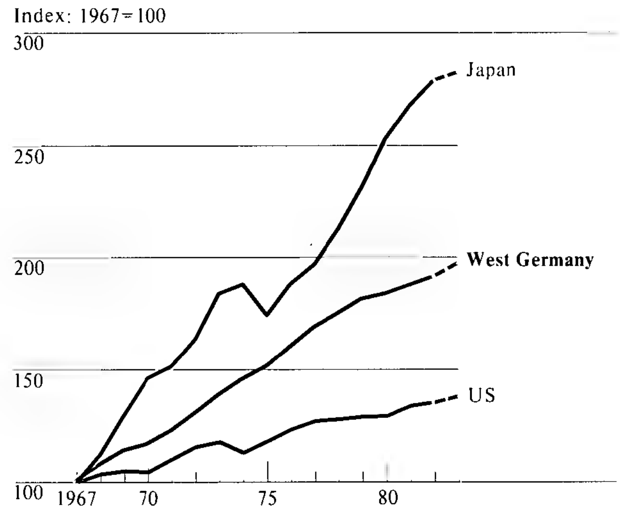
Although impossible to quantify, the West German work force's reputation for dependability, hard work, and a superior product appears to be eroding. A recent poll indicated that the work ethic in West Germany had declined to "an incredible extent" and was the lowest of the countries surveyed. West German working hours already are among the shortest in the OECD and will fall markedly when the 38.5-hour workweek (at 40 hours' pay) begins next year for a large share of West German workers.

In the 1950s and 1960s, large productivity increases allowed for rapid wage increases while maintaining competitiveness. Over the past decade, however, sluggish investment and aging of the capital stock have led to slower productivity growth. West German output per worker rose on average at nearly 6 percent in 1961-73 but at slightly less than a 4-percent rate in 1974-82. Japan's record is better, while the US record is worse.

Weak Financial Position of West German Firms. The primary sources of West German investment funding are business profits and bank lending. Stocks and bonds represent less than 5 percent of funds raised by West German nonfinancial companies. The profitability of West German firms has declined steadily for over a decade. During 1978-82, West German corporations averaged barely 7

Productivity in Manufacturing, 1967-83

25X1



Note: Dashed lines are estimated.

25X1

25X1

303932 (C00468) 10 84

percent in net return on equity capital, while the French average was 8 percent, British and Japanese 10 percent, and US 14 percent. Poor profitability has clearly weakened the equity capital base of West German industry. The equity capital ratio"[2] fell from 30 percent in 1967 to 18.5 percent in 1982, lessening the ability of business to undertake investment and withstand business reverses.

25X1

25X1

Administrative/Regulatory Bottlenecks. Complaints about administrative and other barriers to innovation and investment have multiplied since the mid-1970s. With a highly codified legal structure, Germans look to the courts to adjudicate civil disputes that elsewhere would tend to be settled by compromise or arbitration. Moreover, environmentalists are increasingly influential in West Germany, and have blocked or delayed a number of power

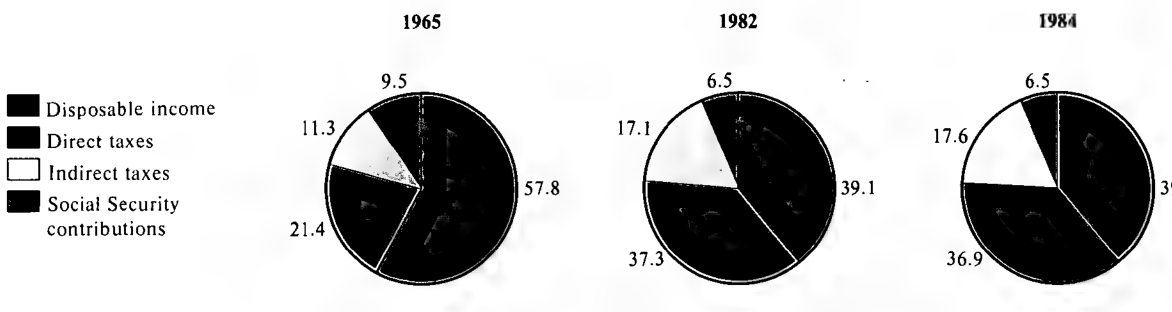
25X1

[2] Capital stock plus reserves as a percent of total assets.

25X1

West Germany: Marginal Tax and Social Contribution Rates, 1965, 1982, and 1984[a]

Percent



[a] For average single-wage earner.

[redacted]
303455 (C00196) 8-84

25X1

station and public works projects through legal and other means. [redacted]

Business complaints about bureaucratic obstructions most frequently mention layoffs. To fire an employee without a legal proceeding is almost impossible. This encourages firms to avoid new hiring when business is good and to rely instead on overtime. To close an unprofitable activity requires an onerous compensation plan for dismissed personnel that frequently causes firms to put off rationalization. Establishing a new business involves applications requiring up to 150 approvals, and moving a plant to a new location entails several hundred approvals. [redacted]

Government "Crowding Out." Rapid growth of government spending was a source of alarm for the conservative business and financial community until the Kohl government's austerity program successfully halted the trend over the past two years. Government spending at all levels, including transfers and interest, grew from $104 billion in 1970 to $313 billion in 1982. As a share of GNP, spending jumped from 39 percent to 50 percent, the highest level in the Big Seven. The major contributor to the rapid growth of government spending, after social programs, was interest on government debt. [redacted]

25X1

25X1

In the postwar economic miracle years, West German governments moved to improve and protect living standards by developing an array of lavish social programs. Social spending now claims one-third of West German GNP, compared with 19 percent in the United States. West Germans enjoy the highest per capita social benefits in the EC. Certain programs are particularly generous: tuition-free university education plus interest-free student loans, paid maternity leave for five months, unemployment compensation of up to 80 percent of aftertax salary for the first year, four-week visits to medical spas every three years, and almost unlimited paid sick leave. [redacted]

25X1

25X1

The burden of government spending is reflected in increasing taxes. The average worker will contribute over 40 percent of his income for taxes and social levies this year. The marginal rate of taxation now reaches 63 percent— compared with about 42 percent in 1965. Only French taxes in the Big Seven exceed West Germany's. For employers, high and growing contributions to government social programs put a tight squeeze on the profits of many companies, discouraging hiring and investment and contributing to the record number of bankruptcies.

Government Efforts To Encourage a Turnaround

The Kohl government has taken some first steps to restructure industry, bolster competitiveness, revamp the cumbersome and expensive social welfare program, and stimulate lagging investment. It has given priority to reducing the budget deficits since Kohl assumed power two years ago, on the assumption that fiscal consolidation would lower interest rates and revive investor confidence. Bonn also is playing a growing role in encouraging the development of advanced manufacturing technology by coordinating and funding private R&D and calling attention to West Germany's high-tech gaps and successes.

However, Kohl's policy of promoting a more market-oriented environment for West German firms has made little progress. Indeed, bureaucratic obstacles and the system of subsidies have increased under the Kohl government. After a bold start in trimming social programs, Bonn eased off in the face of labor union and other protests. We believe West German businessmen perceive a drift in economic policy that is inhibiting their longer range investment plans.

Outlook

West German Government and business leaders are acutely aware of the existing obstacles to growth and are taking first steps to overcome them:

- Overconfident attitudes of West German economic leaders have been replaced, in our view, by respect for and readiness to learn from Japanese technology and US entrepreneurship. Joint ventures and other forms of technology exchange with Japanese and US firms are increasing, and the West German financial market is looking closely at the United States as a model for reforms.

- West German firms are trying to speed reaction time to market developments, intensify R&D, and update product lines, looking in particular toward microelectronics. 25X1

- The financial position of West German firms should strengthen over the next few years, as profitability improves with recovery. Some movement in stimulating the stock market and forming venture capital companies are already evident. 25X1

The economic environment for innovation probably will be neutral at best over the next few years. Our econometric model of the West German economy forecasts an average annual real GNP growth for 1985-87 of 2.5 percent, assuming fairly robust world trade and continued low oil prices. Past sources of growth, investment, and exports, will be present but less dynamic. The key obstacles to investment will continue to include: 1) government inability to create an environment more conducive to business confidence; 2) high taxes and overgenerous social benefits that diminish incentives; and 3) socioeconomic factors that retard adaptation to changes in technology, finance, and marketing. Concerning trade, we expect West Germany to have a hard time maintaining its 13-percent share of world nonoil exports in an environment of intensified world competition. 25X1

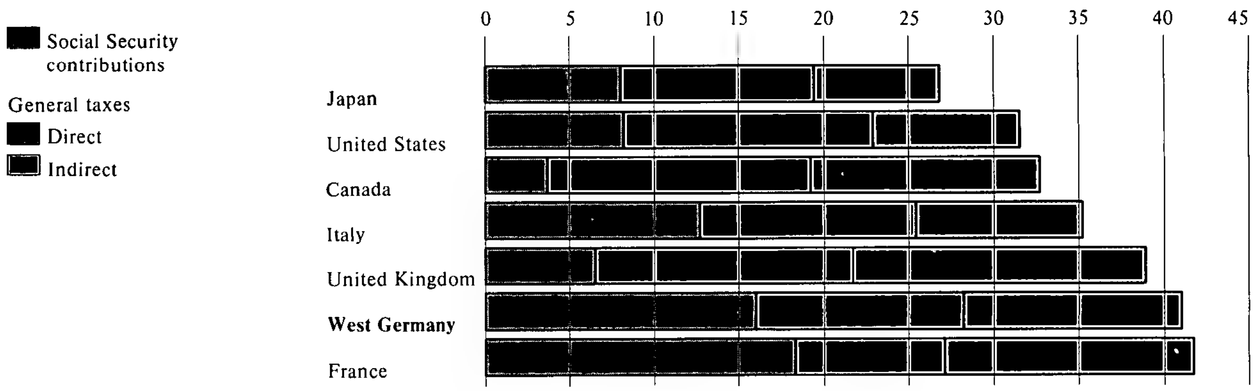
25X1

25X1

Although a century of German industrial leadership will not dissipate quickly or easily, in our view West Germany's high-technology gap will persist at least for the next several years. Given the accelerating pace of change in high tech, West Germany's own successes plus assimilation of foreign technology may leave it in the same relative position. Even

Selected Industrial Countries: Comparative Tax Burden, 1981

Taxes as a percent of GDP



303456 10-84

25X1

in the best of circumstances, the required changes in the conservative German business and social fabric will take time.

25X1

We expect that the Kohl government will not be inclined to push hard enough to achieve innovation in economic policy.

25X6

25X6

- Economics Minister Bangemann is new and inexperienced, and Finance Minister Stoltenberg is single-mindedly fixated on budget consolidation.
- The government probably will continue to be saddled with budget deficits, although these will be low by international standards. Even the modest success of the recovery will be a temptation not to press forward on the politically most contentious planks of the government's reform program, especially with Kohl and his party facing reelection in 1987.

A sluggish and less confident West German economy has serious implications for Bonn's relations with its West European neighbors and with the United States. In such conditions, the government would be even more likely to show:

- Reluctance to boost military spending and contributions to NATO programs.
- Resistance to measures that could jeopardize Eastern Bloc markets.
- Concern about a US budget that could jeopardize Eastern Bloc markets.
- Concern about US budget deficits, interest rates, and volatility of the dollar.
- Increasing sensitivity over bilateral trade differences.

25X1

25X1

25X1

Morocco-Libya: Implementation of the Union [redacted] 25X1

Libya and Morocco are moving rapidly to implement their union agreement and demonstrate that the accord is providing tangible economic benefits. Access to Libya's still substantial financial resources and oil will help King Hassan temper growing domestic disgruntlement over deteriorating economic conditions. Libyan leader Qadhafi has secured a source of skilled labor and agricultural goods, and possible access to restricted US-origin spare parts for aircraft and other equipment. The union also promotes the interests of the two leaders in broadening their international contacts. The long-term viability of this accord, however, will depend in part on Qadhafi's ability to improve his poor track record on financial commitments. He also will have to avoid pressing Hassan for public support of Libya's more radical initiatives against the United States, Israel, and moderate Arab governments. [redacted]

A Year in the Making

The rapprochement between Morocco and Libya began in late June 1983 after Hassan bowed to Saudi pressure and agreed to see Qadhafi. During his visit, Qadhafi promised to back Morocco on the Western Sahara issue and to withdraw his support to the Polisario Front. In turn, Hassan agreed not to act against Libyan interests in Chad. [redacted]

Hassan first proposed a union in mid-July 1984. Qadhafi and Hassan signed the federation treaty at Oujda, Morocco, on 13 August, and the union was approved in referendums held in Morocco and Libya by the end of the month. [redacted]

Hassan and Qadhafi will preside jointly over the union. The headquarters will alternate between the two capitals, with permanent representatives in each. Morocco's former Minister of Cooperation Radi, a socialist, is Secretary General of the union, and Kamal Hasan al-Maqhur, former Libyan Petroleum Minister and president of OPEC, is the assistant secretary general. Joint political, defense, economic, and education councils are to be established. The agreement calls for coordination of foreign policy, cooperation in economic development and defense, and the creation of an Executive Committee, Federal Court, and Federal Parliament. Each country retains control of its domestic affairs. [redacted] 25X1

Economic Dynamics of the Relationship

The accord follows a year of growing economic relations. Libya reportedly has given Morocco a $100 million grant, $190 million in credits, and has accepted an estimated 15,000 to 20,000 Moroccan workers. 25X1 Tripoli has supplied as much as 15 percent of Morocco's oil on favorable terms and provided an important market for Moroccan agricultural exports. [redacted] 25X1

Hassan has encouraged the popular belief that 25X1 Qadhafi has offered almost $1 billion in economic assistance to Morocco during the next year [redacted] This package—about one-half is to be in cash—would be one of the largest 25X1 Qadhafi has ever offered and, if fulfilled, would 25X1 displace Saudi Arabia as Morocco's principal financial benefactor. Tripoli advanced $50 million to Rabat in September to help pay Morocco's international creditors [redacted] 25X1 25X1

Arab-African Federation
Morocco-Libya


Moroccan King Hassan


Libyan Leader Qadhafi

Presidency

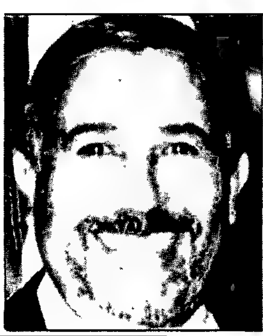
Moroccan Secretary General
Libyan Assistant

Joint Councils

Political | Defense | Economic | Educational

Advisory groups:	**Executive Committee—** members of Moroccan Council of Ministers and Libyan General Peoples' Committee execute decisions of Presidency **Federal Court—** to adjudicate disputes in implementing pact	**Federal Parliament—** members of Moroccan Parliament and Libyan Peoples' Congress recommend proposals to strengthen treaty objectives

Objectives of union:	Firm diplomatic coordination in international affairs Economic cooperation to achieve technical, industrial, agricultural, commercial, and social development	Mutual defense Educational cooperation to maintain moral value in Islamic teaching . . . exchange teachers and students . . . joint university education and research


Abdelouahed Radi
Possible First Secretary General of the Arab-African Federation

Kamal Hasan al-Maqhur
Assistant Secretary General of the Arab-African Federation

25X1

304039 11-84

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000707260001-0

25X1

The remainder of Libyan aid will consist of oil and military materiel, including small arms and light armored vehicles [redacted] The US Embassy in Rabat says that Morocco has signed a contract for up to 3.5 million barrels of Libyan crude oil to be delivered before April, possibly at concessional rates. The volume involved would provide about 10 percent of Morocco's needs and help reduce the one-third share of oil purchases in Rabat's import bill. Morocco also may be considering refining Libyan oil to help circumvent Tripoli's OPEC production quota. Tripoli can finance its total aid commitment to Rabat with revenues from about 95,000 barrels of oil per day—less than 10 percent of current oil production. [redacted]

Libya provides a ready market for Morocco's agricultural and manufactured exports to offset domestic shortages. Of particular concern is food, which soaks up over $500 million in foreign exchange annually. Morocco exported only $18 million worth of goods to Libya last year—about 1 percent of its total exports—but hopes to boost these exports to $100 million by 1986. This increase would provide a major shot in the arm to Morocco's stagnant agricultural exports, which are being hurt by quota restrictions in the European Community. [redacted]

Jobs for Moroccan workers in Libya are particularly important to Rabat because of already high domestic unemployment—30 percent of the labor force—and the prospect that a large number of workers will be returning home as a result of industrial restructuring in Western Europe. Under the accord, Tripoli plans to replace Tunisian, Egyptian, and other foreign workers with about 80,000 Moroccans. Remittances from Moroccans working in Libya totaled only $16 million in 1983, but under the union are likely to rise, rapidly stemming the decline in this important source of foreign exchange, which totaled $900 million last year. The US Embassy in Tunis reports that Qadhafi recently threatened to expel all 70,000 Tunisians working in Libya by 31 December and replace them with Moroccans, although such a move would be logistically difficult. Qadhafi's statement underscores his willingness to bring in large numbers of Moroccans. [redacted] 25X1

Cooperation on merging the national airlines and on shipping also is moving apace [redacted] An agreement has reportedly been signed and includes: 25X1 25X1 25X1

- Moroccan procurement of spare parts for Libya's commercial airlines.
- Moroccan help in procuring European commercial aircraft for Libya.
- Morocco's agreement to take over the operation of passenger ships between the two countries.
- Libya's agreement to operate an undetermined number of Moroccan cargo ships.

The US Embassy in Rabat reported in September that some Moroccan aircraft technicians already had gone to Libya. [redacted] 25X1

The airline merger, if implemented, would provide significant advantages to both sides. The Moroccan airline would gain access to Libya's more abundant financial resources and extensive traffic rights, while offering Tripoli the strong organizational skills and efficiency of Morocco's airline. Qadhafi probably will use this arrangement to request restricted US aircraft spare parts for his US-origin fleet. [redacted] 25X1 25X1 25X1

Union Politics

Hassan probably hopes the union will allay pressures caused by the Western Sahara conflict and Morocco's deteriorating social and economic conditions. Qadhafi has promised to support Morocco on the Western Sahara issue and not to provide military assistance to the Polisario Front. He also may help Hassan gain economic or military assistance from the USSR [redacted] 25X1

Qadhafi's motives in signing the agreement are both tactical and ideological. He will draw on the union to enhance his influence in regional affairs, to strengthen his international standing, and to counter US attempts to isolate him. He almost certainly hopes that improved relations with other moderate governments will weaken their relationship with Washington. The union, we believe, will encourage Qadhafi to more aggressively pursue his longstanding policy of threatening other Arab states with subversion unless they unite in a more militant posture toward Israel. [redacted]

Prospects for the Union

Hassan's personal prestige is now engaged, and we anticipate that he will resist strongly any pressure to repudiate the union. As long as Qadhafi provides some economic support, backs Morocco on the Western Sahara, [redacted] Hassan will move forward with the union. Hassan may use the Libyan deal as a bargaining chip in obtaining new aid from the West. [redacted] 25X1

Morocco's turning over Libyan dissidents to Qadhafi [redacted] have given Qadhafi an important stake in maintaining good relations. As a result, Qadhafi is likely to continue promoting economic cooperation with Morocco and to give limited financial aid to keep the union on track. [redacted] 25X1

Qadhafi's consistent failure to deliver on past promises of aid—especially large aid commitments—and the bleak outlook for oil revenues, however, suggests that over time he will fail to honor his commitments on a level satisfactory to Hassan. A major shortfall in expected financial assistance probably would introduce significant strain in the relationship. [redacted] 25X1

In addition, we expect that Qadhafi in time will try to involve Hassan in his radical stand against the United States and Israel and in his adventurism in the region. Such moves also are likely to reduce Hassan's motivations for implementing the union. 25X1

[redacted] 25X1

25X1

25X1

Page Denied

Next 1 Page(s) In Document Denied

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000707260001-0